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SUBJECT: CRITICAL ECONOMIC TIMES: IMF MISSION PACKS UP AND GOES HOME

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¶1. (SBU) SUMMARY: An IMF mission visited Moldova from May 28 to June 8 to negotiate a new agreement. Following unproductive discussions with Government of Moldova (GOM) officials, the mission departed without a new arrangement. The IMF projected that Moldova's GDP would decrease nine percent or more for 2009 and noted that the Moldovan government budget was facing a severe deficit because of mismanagement. The linchpins of economic growth in Moldova for several years, remittances and foreign direct investment (FDI), have dropped dramatically. The National Bank of Moldova has intervened heavily in the foreign exchange market to support the national currency, the Leu. The strong Leu, together with the impact of the economic crisis on the region, has made Moldovan exports too costly for export markets. The ruling Party of Communists (PCRM) is focused solely on new elections and the short-term economic developments. END SUMMARY

GOM MISMANAGEMENT LED TO BUDGET CRISIS

¶2. (SBU) The GOM is facing a sharp drop in GDP and a budget deficit of 11 percent or more in 2009. While the IMF mission noted that the regional economic decline was partly responsible for Moldova's economic troubles, it pointed to the GOM and its misguided policies as the principal culprit for the budget catastrophe. The government had taken counterproductive measures since summer 2008 by raising salaries and pensions, as part of an effort to maintain popularity in the run-up to the April elections. Further, the GOM had consistently refused to reduce staff or substantially cut spending as revenues plummeted. The GOM was already delaying payments of salaries, services and pensions. The IMF projected that the government would need $550,000,000 immediately, followed by another $250,000,000 from bilateral donors, to fill the revenue void in the budget. The GOM is unable to raise money through bonds because Moldova is a high risk. Commercial loans would be prohibitively expensive should the GOM be able to find banks willing to provide support. Paris Club members are unlikely to consider deferring payments on outstanding loans or issuing new loans to a country without an IMF agreement.

REMITTANCES AND FDI COLLAPSE

¶3. (SBU) Remittances and foreign direct investment (FDI) have spurred Moldova's economic growth, averaging over six percent annual growth since 2001. Remittances from the approximately one million Moldovans working abroad equaled 37 percent of GDP in 2007 and FDI surpassed USD 600 million in 2008. The IMF had long advised the GOM to be prudent, noting that remittances could be a volatile revenue

source. Remittances have dropped 40 percent in 2009, proving the folly of the GOM's reliance on this fluctuating source. The GOM derives approximately 70 percent of its revenues from tariffs levied on imports which, in turn, are financed primarily by remittances. In addition, FDI has fallen 70 percent in the first five months of 2009, adding to Moldova's economic woes.

THE NATIONAL BANK AND BANKING SECTOR

¶4. (SBU) The National Bank of Moldova's (NBM) policy of foreign exchange intervention has eroded the competitiveness of Moldovan products and drained liquidity from the financial system. Moldovan banks' already weak ability to offer credit to the economy has been further eroded. The IMF was very concerned that one of the sixteen banks in Moldova was near bankruptcy. On Friday, June 19, the NBM withdrew the license of Investprivatbank. Should the GOM fail to handle carefully the liquidation of Investprivatbank, the government could easily incite a run on banks by mishandling the crisis. Dozens of protestors waited in front of Investprivatbank on Monday morning, June 22, demanding the return of their deposits.

WHAT MOLDOVA COULD, SHOULD, BUT WON'T DO

¶5. (SBU) One option the GOM could consider at this time would be to approach the Paris Club for debt relief. However, the IMF mission considered this step unlikely, since the government would need to disclose its lack of an arrangement with the IMF. Bilateral support from western countries is also highly unlikely without an IMF agreement. Russia may be a possible creditor, since it may consider increasing its influence in a former republic of the Soviet Union

more important than following standardinternational lending practice. The GOM could brrow from the National Bank or print money, but the IMF considered it unlikely that the government would take either of these measures. The IMF underlined that Parliament, which is responsible for approving and adjusting the budget, needed to rectify the budget and balance government consumption and revenues. The IMF deemed it important for the GOM to preserve social spending and strengthen investment. The IMF mission's statement noted that, unless Moldova implemented budget rectification and legislative changes, the prospects for a deep and prolonged recession would continue to grow.

COMMENT

¶6. (SBU) The previous IMF agreement expired at the end of May 2009. The IMF mission stated before its departure that it stood ready to support Moldova, should a new government request it. A new government and political stability would need to precede a new IMF mission in the autumn to negotiate a new agreement. The IMF predicted that the GOM could continue to ignore the pending budget crash and to pay pensions for another two or three months. The parliament elected on April 5 failed to elect a new president and Moldova has been mired in a political crisis, with repeat parliamentary elections to take place on July 29. The strategy of the ruling PCRM will be to maintain that the economic situation is not as serious in Moldova as in neighboring countries and to campaign on the slogan that a vote for the PCRM is a vote for stability. The PCRM may speculate that pensioners who form a strong base for the party will be home in August while many others, more likely to support the opposition, will be away on vacation. Meanwhile, the Moldovan economy continues unhindered towards a crash.

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